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Supreme Court of the United States

OCTOBER TERM, 1961

No. 409

ESTATE OF WILLIAM P. COOPER, ETC., et al.,
PETITIONER,
versus
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

PERPETUAL BUILDING & LOAN ASSOCIATION OF COLUMBIA, PETITIONER,
versus
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

COOPER AGENCY, PETITIONER,
versus
COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

EDWARD W. MULLINS,
1321 Bull Street,
Columbia, South Carolina,
Counsel for Petitioners.

Of Counsel:
NELSON, MULLINS, GRIER
& SCARBOROUGH,
1321 Bull Street,
Columbia, South Carolina.

The R. L. Bryan Company, Legal Printers, Columbia, S. C.

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ESTATE OF WILLIAM P. COOPER, ETC., et al.,
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COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

Petitioners, the Estate of William P. Cooper, deceased, the Perpetual Building & Loan Association of Columbia, and the Cooper Agency, each respectfully pray for a Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit to review the judgments of that Court entered June 19, 1961, affirming the decisions of the Tax Court of the United States relating to the Petitioners herein.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court in the case of *the Estate of William P. Cooper* appear in T. C. Memo 1960-98. (R. 206-226.)*

The findings of fact and opinion of the Tax Court in the *Perpetual case* are reported at 34 T. C. 74 (155-189) and in the *Cooper Agency case* at 34 T. C. 81. (R. 190-205.)

These cases were consolidated in the Court of Appeals for briefing, argument and opinion and that Court filed one opinion disposing of all the cases, which is not yet officially reported. A copy of the opinion appears as Appendix B to this Petition.

JURISDICTION

These proceedings were brought in the Tax Court of the United States under the provisions of Section 6213 of the Internal Revenue Code of 1954. (26 U. S. C. A., Section 6213.)

The jurisdiction of this Court is invoked under the provisions of Section 7482 of the Internal Revenue Code of 1954 (26 U. S. C. A., Section 7482), and 28 U. S. C. A., Section 1254.

QUESTIONS PRESENTED

Estate of William P. Cooper case

Did the Court err in holding that certain building and loan dividends were not taxable to the shareholder until actually withdrawn by his Estate in 1949, where such dividends were credited to the account of the shareholder on the books of the association in 1945, 1946, 1947 and 1948, and were available in cash to the shareholder at any time upon the surrender of his share account in its entirety?

---

* Record references are to the Appendix for the Petitioners below.

Perpetual Building & Loan Association case

Did the Court err in failing to find Section 302(b) of the Revenue Act of 1950 applicable to a building and loan association which had been ruled tax-exempt under Section 101(4) of the Internal Revenue Code of 1939?

Cooper Agency case

Where Cooper Agency borrowed certain construction money from Perpetual Building and Loan Association and paid interest on the full amount of the loan until it was fully paid with building and loan shares purchased by the borrower from the lender during the period of the loan, did the Court err in holding that the interest paid by the borrower was deductible on its tax returns only to the extent of the interest which would have been paid if, instead of purchasing building and loan shares, it had made payments in direct reduction of the loan?

STATUTES AND REGULATIONS INVOLVED

Estate of William P. Cooper case. Section 115(a) of the Internal Revenue Code of 1939 and Treasury Regulations 111, Sections 29.42-2 and 29.42-3.

Perpetual Building and Loan case. Section 101(4), 54(f), 275 of the Internal Revenue Code of 1939 and Section 302(b) of the Revenue Act of 1950.

Cooper Agency case. Section 23(b) of the Internal Revenue Code of 1939.

The material portions of these sections and regulations are set forth in Appendix A.

STATEMENT

Estate of William P. Cooper

Petitioner submits that all material facts here involved are undisputed. The facts as stipulated and as found by the Tax Court and confirmed by the Court of Appeals, insofar as they relate to the issue here presented, may be summarized as follows:

On or about December, 1944, William P. Cooper purchased for cash prepaid installment share accounts of Perpetual Building and Loan Association of Columbia, S. C., in the amount of $2,273.26, which he held until his demise on December 28, 1948. (R. 206, 212.)

On or about December 31, 1945, the account was credited with a so-called "stock dividend of four shares for one, or of $6,819.78. On June 30, 1946, the amount was credited with a "stock" dividend of two shares for one, or of $9,093.04. On December 31, 1946, the account was credited with a "stock" dividend of six shares for one, or of $90,930.40. In 1947 the account was credited with two dividends, totaling $4,408.48, and in 1948 the account was credited with two dividends, totaling $3,920.86. (R. 212, 213, 214.)

The shareholder was entitled, upon surrender of the share account in its entirety, to receive the total amount of the account, including all dividends credited thereto. (R. 209, 220, 221.)

The account was surrendered in full in 1949 by the shareholder's widow and sole legatee, Daisy H. Cooper, Executrix of the Estate of William P. Cooper. (R. 218.)

Perpetual Building and Loan Association

Petitioner submits that all material facts here involved are undisputed. The facts as stipulated and as found by the Tax Court and confirmed by the Court of Appeals,

insofar as they relate to the issue here presented, may be summarized as follows:

Perpetual Building and Loan Association was organized in 1914 and operated in accordance with the laws of the State of South Carolina, under the supervision and control of the South Carolina Board of Bank Control, during the years 1945 to 1951, inclusive. (R. 158.)

On October 21, 1946, the Treasury Department issued a ruling stating that, in its opinion, based upon the evidence presented, Perpetual Building and Loan Association was exempt from Federal income tax under the provisions of Section 101(4) of the Internal Revenue Code of 1939. (R. 160.)

For each of the years 1945 to 1951, inclusive, Perpetual Building and Loan Association duly and timely filed the information return (Form 990) required by Section 54(f) of the Internal Revenue Code of 1939. (R. 159-160.)

In 1952 Perpetual Building and Loan Association was ruled not to have been exempt during the years 1945 to 1951, inclusive, on the ground that, in addition to making loans to members, it was carrying on business for profit. (R. 156, 180.)

In 1956 the Commissioner of Internal Revenue determined deficiencies in income tax, declared value excess profit tax, and additions to the tax under Section 29-1(a) of the Revenue Code of 1939, in the amount set forth in the opinion of the Tax Court. (R. 157.)

No amount of income or other taxes for any of the years 1945 to 1951, inclusive, was assessed against Perpetual Building and Loan Association within three years after its filing of the information return (Form 990) required by Section 54(f) of the Internal Revenue Code of 1939.

Cooper Agency

Petitioner submits that all material facts here involved are undisputed, and may be summarized as follows:

Cooper Agency

During its taxable years 1950 and 1951, Cooper Agency borrowed from Perpetual Building and Loan Association $600,000.00, which amount was advanced to said borrower for and during the construction of 198 small houses in the Greenview subdivision near Columbia, South Carloina. (R. 193-195.)

During the period of said construction loan, Cooper Agency made payments which were not immediately applied in reduction of said loan, but were applied toward the purchase of building and loan shares in the amount of $600,000.00, to which the borrower had subscribed when the loan agreement was made. (R. 193-195.)

When the borrower's payments and accumulated dividend credits on shares in the building and loan association exceeded the loan, the share credits were applied in payment of the loan. In the meantime, Perpetual charged interest at the rate of 7 per cent. per annum on the entire loan of $600,000.00 from the time of the inception of the loan. (R. 193.)

REASONS FOR GRANTING THE WRIT

Estate of William P. Cooper

The Decision below contravenes the manifest purpose and intent of Treasury Regulation 111.

The doctrine of constructive receipt treats as taxable income that which is unquestionably subject to the demand of the taxpayer, whether or not such income has actually been received in cash. It is clear that the shareholder, by surrendering his passbook and withdrawing the account in

full, had at any time he might desire, the right to collect the dividends which had been credited to his account. (R. 225-226.) The right of the shareholder to receive the dividends from Perpetual was the same at all times after the dividends had been credited to his account on his passbook and on the books of Perpetual, and his right to dividends did not accrue by reason of his death. There was no contention by the Commissioner that his rights were enhanced by his death, or that Perpetual was any less obligated, before than after his death, to pay the dividends to which the shareholder was entitled upon the surrender of the share account in its entirety. The Tax Court found in its opinion (R. 221):

> "There was no legal impediment to the right of the Estate to the proceeds of the account upon surrender of the account in its entirety. There was likewise no *de facto* impediment to the accomplishment of this result in view of the practical control of Perpetual by the Cooper family, some of whom had already surrendered their share accounts, and received the full amount of the credits to their accounts."

The dividends credited on the books to William P. Coooper in the years 1945, 1946, 1947 and 1948 were taxable to him as ordinary income for the years in question and hence could not be taxed against his Estate on the theory that such taxable income was received by the Estate in the year 1949.

The decision of the Tax Court, affirmed by the Court of Appeals, is contrary to the landmark case of *Ross v. Commissioner,* 169 Fed. (2d) 483, in which the Court of Appeals for the First Circuit in an opinion by Mr. Justice Frankfurter held that the taxpayer may assert the doctrine of constructive receipt to defeat an attempt by the Commissioner of Internal Revenue to assert a tax in a later year.

Perpetual Building & Loan Association case

The decision below contravenes the manifest purpose and intent of Congress in enacting Section 302(b) of the Revenue Act of 1950.

The Tax Court and the Court of Appeals held that Section 302(b) of the Revenue Act of 1950 was only intended to apply to organizations which had been exempted under paragraphs (1), (6), or (7) of Section 101 of the Internal Revenue Code of 1939 and was not intended to cover organizations claiming exemption under subsection (4). (R. 186.)

We submit the express language of Section 302(b) clearly shows that it was intended to apply to any organization which had been ruled exempt under any subsection of 101. (See Appendix B.)

That such was the intention of Congress is supported by the following Congressional Committee report:

> TRADE OR BUSINESS INCOME AND EXEMPTION PREVIOUSLY GRANTED
>
> "Section 302(b), as added by your committee, provides that for any taxable year beginning prior to January 1, 1951, no organization which has been advised by the Bureau of Internal Revenue in a letter to such organization that such organization was exempt from taxation under section 101 of the code shall be denied exemption from income tax under such section, on the ground that it is carrying on a trade or business for profit, unless, prior to such date the Bureau of Internal Revenue has, in a letter to such organization, informed such organization that its exemption under such section was withdraw or requested further information from such organization relative to its exempt status. In no event shall exemption be so denied for any such taxable year prior to the taxable year in which such letter requesting information was mailed to such organization, or, if no letter so requesting information was mailed, prior to the taxable year in which such letter, informing the organization that its exemption

was withdrawn, was mailed." U. S. CODE CONGRESSIONAL SERVICE-81st CONGRESS, SECOND SESSION 1950 Volume 2, page 3178. Also, see page 3243.

The Tax Court and the Court of Appeals erred in holding that filing of forms 990 were not sufficient to start the running of the Statute of Limitations in this case because of the decision of this Court in *Automobile Club of Michigan v. Commissioner*, 353 U. S. 180. In the *Automobile Club case* the assessment against the taxpayer had been made prior to September 20, 1950 and hence under the express language of Section 302 (b) that section was not applicable.

Cooper Agency case

Did the Court err in holding that the loan transaction was a sham and lacked any economic substance because the lender failed to apply payments in direct reduction of the loan and, instead, applied such payments toward the purchase of shares for which the borrower had subscribed at the time the loan was made?

The Tax Court held and the Court of Appeals agreed that the transaction was a sham and was lacking in economic reality because the amount borrowed was highly in excess of the reasonable financial needs of the business venture in question (R. 200.)

The amount of the loan was clearly not excessive unless the partial payments made by the borrower from time to time were required to be applied in direct reduction of the loan instead of being applied in payment for shares in the Building & Loan Association for which the borrower had subscribed. The agreement of the borrower to purchase shares in the amount of the loan and to apply such shares, when fully paid for, in cancellation of the loan was in accordance with the By-laws of this and all other mutual building and loan associations.

It is submitted that the interest paid by the Petitioner, Cooper Agency, on the loan of $600,000.00 constitutes

"Interest paid * * * on indebtedness,"

within the meaning of 23 (b) of the Internal Revenue Code of 1939.

The holding of the Court below that the transaction should be disregarded because it lacked economic substance is contrary to the decision of the Ninth Circuit in *Wilshire & West, Sandwiches v. Commissioner of Internal Revenue* (1949), 175 F. (2d) 718-720, and the decision of the Second Circuit in *Kraft Foods Company v. Commissioner of Internal Revenue* (1956), (C. A. 2) 232 F. (2d) 118-127.

In *Knetsch v. United States*, 364 U. S. 361, this Court put aside the finding by the District Court that Knetsch's only motive was an attempt to secure an interest deduction and held "the question for determination as to whether what was done, apart from the tax motive, was the thing which the statute intended." The Court disallowed the interest deduction in that case because

> "It is patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction."

In the present case we submit it is clear that the loan in question did not lack economic substance within the meaning of the decision of this Court in the *Knetsch case*.

Throughout the opinion of the Tax Court, affirmed by the Court of Appeals, there runs the recurring theme that the taxpayer cannot or should not obtain the claimed interest deduction where its primary motive was tax avoidance. This is contrary to the decision of this Court in the *Knetsch case*.

As to the transaction lacking in economic reality, Congress has not seen fit to place any general restriction on interest deductions except in a few specific instances not

applicable here. Unlike the provisions of the Revenue law allowing deductions for business expense the provision allowing deduction for interest contains no limitation as to the reasonableness of the amount of the loan upon which interest is to be deducted.

If commercial substance is to be the test the Commissioner will have to examine into transactions "where a taxpayer borrows money at five or six per cent to purchase securities that only pay nominal interest; or where, with money in the bank earning 3%, he borrows from the selfsame bank at a higher rate." Dissenting opinion of Mr. Justice Douglas in the *Knetsch case*.

CONCLUSION

For the reasons given Certiorari should be granted.

Respectfully submitted,

EDWARD W. MULLINS,
1321 Bull Street,
Columbia, South Carolina,
Counsel for Petitioner.

Of counsel:

NELSON, MULLINS, GRIER
& SCARBOROUGH,
1321 Bull Street,
Columbia, South Carolina.

APPENDIX A

Statutes and Regulations

Internal Revenue Code of 1939:

Sec. 23 **Deductions from Gross Income.**

(b) **Interest.**—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

* * *

(26 U. S. C., 1952 Ed., Sec. 23.)

Sec. 54. **Records and Special Returns.**

* * *

(f) (As added by Sec. 117(a), Revenue Act of 1943, c. 63, 58 Stat. 21.) Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may from time to time prescribe. * * *

* * *

(26 U. S. C., 1952 Ed., Sec. 54.)

Sec. 101. **Exemptions from Tax on Corporations.**

* * *

(4) Domestic building and loan associations substantially all the business of which is confined to mak-

ing loans to members; and cooperative banks without capitol stock organized and operated for mutual purposes and without profit.

* * *

(26 U. S. C., 1952 Ed., Sec. 101.)

Sec. 115. **Distributions by Corporations.**

(a) **Definition of Dividend.**—The term "dividend" when used in this chapter means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

* * *

Sec. 275. **Period of Limitation Upon Assessment and Collection.**

Except as provided in Section 276—

(a) **General Rule.**—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in Court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * *

(26 U. S. C., 1952 Ed., Sec. 275.)

Revenue Act of 1950, c. 994, 64 Stat. 906:

Sec. 302. **Exemption of Certain Organizations for Past Years.**

* * *

(b) Period of Limitations.—In the case of an organization which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit, the filing of the information return required by section 54(f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the fil-

ing of a return for the purpose of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). In the case of such an organization which was, by the provisions of section 54(f) of the Internal Revenue Code, specifically not required to file such information return, for the purposes of the preceding sentence a return shall be deemed to have been filed at the time when such return would have been filed had it been so required. The provisions of this subsection shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950, (1) any amount of tax was assessed or paid, or (2) a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer.

* * *

Treasury Regulations 111:

Sec. 29.42-2. **Income not Reduced to Possession.**

Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

Sec. 29.42-3. **Examples of Constructive Receipt.**

* * * Interest credited on savings bank deposits, even though the bank nominally has a rule, seldom or never enforced, that it may require so many days' notice before withdrawals are permitted, is income to the depositor when credited. An amount credited to shareholders of a building and loan association, when such credit passes without restriction to the shareholder, has a taxable status as income for the year of the credit. * * *.

APPENDIX B

United States Court of Appeals

FOR THE FOURTH CIRCUIT

No. 8295

ESTATE OF WILLIAM P. COOPER, DECEASED, DAISY H. COOPER, EXECUTRIX, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

No. 8327

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER AND CROSS-RESPONDENT

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT AND CROSS-PETITIONER

No. 8328

COOPER AGENCY, PETITIONER AND CROSS-RESPONDENT,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT AND CROSS-PETITIONER

ON PETITION AND CROSS-PETITIONS TO REVIEW THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

(Argued June 13, 1961. Decided June 19, 1961.)

Before SOPER, HAYNSWORTH AND BOREMAN, CIRCUIT JUDGES.

PER CURIAM:

These cases relate to the income tax liability of certain corporations controlled by three brothers—Frank B. Cooper, Charles F. Cooper, and James D. Cooper—whose

tax liabilities from activities in the development of real estate and in other fields were considered by us in *Biltmore Homes, Inc., et al. v. Commissioner*, decided March 27, 1961. In that case we affirmed the decision of the Tax Court, which held that profits earned in 1947 and 1948 in the development of a tract of land by Biltmore Homes, Inc., a corporation owned by the three brothers, were not chargeable to the Perpetual Building and Loan Association of Columbia or to the Mutual Savings and Loan Company, which had been certified as exempt from Federal income taxes, but were in fact chargeable to the three brothers.

In case No. 8295 the Tax Court held the estate of William P. Cooper, deceased, liable for income taxes on dividends declared by Perpetual in his lifetime on certain prepaid instalment share accounts held by him but not payable or paid until after his death.

In case No. 8327 now before us on this appeal the Tax Court held that the retroactive withdrawal of the exemption of Perpetual from Federal income taxation by the Commissioner was a valid exercise of its power under the taxing statute, since the corporation lacked the essential characteristics of a legitimate building and loan association and since it had been used by the three brothers as a means of avoiding taxation on profits derived from real estate transactions carried on through Perpetual for their benefit. In this case the Tax Court also held that the assessment and the collection of taxes due were not barred by limitations, since proper income tax returns had not been filed by Perpetual.

In case No. 8328 the Tax Court disallowed a deduction of interest at 7 per cent. on a total sum of $600,000 claimed by the Cooper Agency, a corporation owned and controlled by members of the Cooper family, to have been borrowed from Perpetual, since the court found that the transaction lacked economic reality and a much smaller sum was actually borrowed and used on which an interest deduction was allowed.

Exhaustive statements of the facts in these cases, which are conceded to be correct, are set forth and the issues of law involved are carefully and correctly discussed in the

opinions of Judge Fisher speaking for the Tax Court. See *Perpetual Building and Loan Association of Columbia v. Commissioner*, 34 T. C. 74; *Cooper Agency v. Commissioner*, 34 T. C. 81; *Estate of Cooper v. Commissioner*, T. C. Memo 1960-98.

In our judgment the conclusions reached in these opinions are completely justified and, accordingly, the decisions are affirmed for the reasons that are therein set forth.

Affirmed.

APPENDIX C(a)

JUDGMENT

Filed and Entered June 19, 1961

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8295

ESTATE OF WILLIAM P. COOPER, DECEASED, DAISY H. COOPER, EXECUTRIX, PETITIONER,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION to Review the Decision of the Tax Court of the United States.

THIS CAUSE came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States, in this cause, be, and the same is hereby, affirmed.

June 19, 1961.

MORRIS A. SOPER,
United States Circuit Judge.

APPENDIX C(b)

JUDGMENT

Filed and Entered June 19, 1961

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8327

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER AND CROSS-RESPONDENT,

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT AND CROSS-PETITIONER

ON CROSS-PETITIONS to Review the Decision of the Tax Court of the United States.

THIS CAUSE came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States, in this cause, be, and the same is hereby, affirmed.

June 19, 1961.

MORRIS A. SOPER,
United States Circuit Judge.

APPENDIX C(c)

JUDGMENT

Filed and Entered June 19, 1961

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8328

COOPER AGENCY, PETITIONER AND CROSS-RESPONDENT,

versus

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT AND CROSS-PETITIONER

ON CROSS-PETITIONS to Review the Decision of the Tax Court of the United States.

THIS CAUSE came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

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June 19, 1961.

MORRIS A. SOPER,
United States Circuit Judge.

SUPREME COURT, U. S.
FILED
NOV 6 1961
JOHN F. DAVIS, CLERK

No. 409

In the Supreme Court of the United States

OCTOBER TERM, 1961

ESTATE OF WILLIAM P. COOPER, etc., et al.,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

COOPER AGENCY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

ARCHIBALD COX,
Solicitor General,

LOUIS F. OBERDORFER,
Assistant Attorney General,

MEYER ROTHWACKS,
KARL SCHMEIDLER,
Attorneys,
Department of Justice,
Washington 25, D. C.

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 469

ESTATE OF WILLIAM P. COOPER, etc., et al.,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

PERPETUAL BUILDING AND LOAN ASSOCIATION OF COLUMBIA, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

COOPER AGENCY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court's memorandum findings of fact and opinion in the case of *Estate of Cooper* v. *Commis-*

sioner (R. 206-226) are not officially reported. Its findings of fact and opinion in the case of *Perpetual Building and Loan Association of Columbia* v. *Commissioner* (R. 155-189) are reported at 34 T.C. 694. Its findings of fact and opinion in the case of *Cooper Agency* v. *Commissioner* (R. 190-205) are reported at 33 T.C. 709. The *per curiam* opinion of the Court of Appeals (Pet. 16-18) is reported at 291 F. 2d 831.

JURISDICTION

The judgments of the Court of Appeals (Pet. 18-20) were entered on June 19, 1961. The petition for a writ of certiorari was filed on September 15, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether both courts below correctly held that the Estate of William Cooper was liable in 1949 for income taxes on dividends declared by Perpetual Building and Loan Association of Columbia during the decedent's lifetime on certain installment share accounts held by the decedent, where the dividends were not paid until after his death.

2. Whether both courts below correctly held that the Commissioner's determination in 1956 of deficiencies in income tax against Perpetual for the years 1945 through 1951 was timely made and was not barred by the statute of limitations, since proper income tax returns had not been filed by Perpetual.

3. Whether both courts below were correct in disallowing a deduction of interest on a total sum of $600,000 claimed by the Cooper Agency to have been borrowed from Perpetual, where the transaction lacked economic reality and a much smaller sum was actually borrowed and used, on which an interest deduction was allowed.

STATUTES INVOLVED

Sections 23(b), 54(f), 101(4), 126(a), 161(a), 275(a) and 276(a) of the Internal Revenue Code of 1939, and Section 302(b) of the Revenue Act of 1950, c. 994, 64 Stat. 906, are set forth in the Appendix, *infra*, pp. 13-16.

STATEMENT

These cases involve the tax consequences of transactions entered into by several organizations, all of which were owned, controlled, managed and dominated by members of the Cooper family. The relevant facts, which were found by the Tax Court (R. 158-175, 191-197, 207-217) and agreed to by the Court of Appeals (Pet. 17-18), may be summarized very briefly as follows:

1. Estate of Cooper

William P. Cooper, the father of Charles, Frank, James and Edwin Cooper, died on December 28, 1948. His wife was executrix under his will.

From 1944 through 1948, William P. Cooper, and three of his sons, James, Frank and Charles, as well

as Charles' wife, Virginia, held installment share accounts with Perpetual (which was controlled and operated by Charles, Frank and James Cooper).

In 1944 William Cooper paid $2,273.26 into his installment share account. Between June 30, 1946, and December 31, 1947, Perpetual declared so-called stock dividends to its installment share accounts. As a result, William's share was credited with $115,172.39 of dividends, and as of the date of his death, December 28, 1948, the appraised value of his account was $117,445.65.[1]

During the period here involved the current dividend paid by Perpetual on other types of share accounts was 4 per cent per annum.

On February 17, 1949, Perpetual repurchased the shares in full from William Cooper's estate for $117,445.65. The payment was paid in escrow to another savings and loan association controlled by the Coopers.

Both courts below held (R. 218-226, Pet. 17-18) that the $115,172.39 of dividend credits constituted ordinary dividends on Perpetual's earnings, and that this amount was taxable as ordinary income to the estate in 1949, the year in which the account was surrendered and the proceeds withdrawn from Perpetual.

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[1] Likewise, Virginia Cooper, having a credit balance in her installment share account of $1,800, received dividend credits of $24,000. Charles Cooper received $50,000 of dividend credits to his account for which he had initially paid in $10,000. Frank Cooper received $45,000 of dividend credits to his account, for which he initially had paid in $9,000; and James Cooper, who had initially paid $9,100 into his account, received $50,000 of dividend credits.

2. Perpetual

Perpetual was chartered as a building and loan association under the laws of South Carolina. It was controlled and operated by Charles, Frank and James Cooper. In 1946, the Commissioner advised Perpetual, based upon information furnished by Charles Cooper, that Perpetual was entitled to an exemption from federal income taxes under Section 101(4) of the Internal Revenue Code of 1939.

For each of the years 1945 through 1951, Perpetual filed an information return, Form 990, with the Collector of Internal Revenue, but did not file any corporation income tax returns for any of these years.

Subsequently, the Commissioner determined that Perpetual had not been operated in accordance with Section 101(4) either when it requested an exemption or afterwards. Accordingly, on November 12, 1952, the Commissioner retroactively revoked his prior ruling and determined that Perpetual was not exempt from taxation for the years beginning with 1944. Perpetual was informed that it was required to file federal income tax returns on Form 1020 beginning with the year 1944, which it failed to do.

Both courts below held (R. 175-184, Pet. 17-18) that Perpetual was not entitled to an exemption from income and excess profits taxes under Section 101(4) for the years 1945 through 1951, on the grounds that it lacked the essential characteristics of a legitimate building and loan association and that it had been used by the Cooper brothers as a means of avoiding taxation on profits derived from real estate transactions carried on through Perpetual for their benefit.

Both courts below also held (R. 184-187, Pet. 17-18) that the Commissioner's determination of deficiencies was not barred by the statute of limitations since proper income tax returns had not been filed by Perpetual for the years 1944 through 1951.

3. Cooper Agency

The four Cooper brothers, Charles, Frank, Edwin and James, owned all of the stock of Cooper Agency in equal amounts and were its sole officers. Three of the Cooper brothers, Charles, Frank and James, purchased a tract of property with money borrowed from Perpetual which they resold to Cooper Agency. Cooper Agency constructed and sold 198 small dwellings on part of this property.

Frank Cooper, on behalf of Cooper Agency, and Charles Cooper, on behalf of Perpetual, orally agreed that Perpetual would loan $600,000 to Cooper Agency to construct the 198 houses. (R. 192, 193.) Perpetual entered $600,000 on its books as "Loans in Process" to Cooper Agency on March 25, 1950. On that date, the first advance of funds to Cooper Agency was made in the amount of $5,000. Thereafter, other cash advances were made periodically. Cooper Agency sold the houses promptly after completion. As houses were sold, the proceeds of sale were paid over to Perpetual. Perpetual charged interest at the rate of 7 per cent per annum on the entire loan of $600,000 from the time of the inception of the arrangement. At no time did Cooper Agency have an outstanding net balance of more than $165,000 owing to Perpetual and during most of the time the net balance owed was much less than $165,000.

On its federal tax returns for 1950 and 1951, Cooper Agency deducted $15,458.42 and $22,794.88, respectively, as interest payments calculated at 7 per cent on $600,000. The Commissioner allowed interest deductions only on the basis of the outstanding balance of funds advanced to Cooper Agency. Both courts below held (R. 198-203, Pet. 17-18) that the so-called $600,000 loan lacked economic reality, that a much smaller sum was actually borrowed and used, and that interest deductions of only $2,369.85 in 1950, and $3,564.79 in 1951, calculated at 7 per cent on the outstanding net balances owed, properly were allowable.

ARGUMENT

The decision below is correct. The questions involved are primarily factual; there is no conflict and no occasion for further review by this Court.

1. Section 126(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 14) provides that all items of gross income in respect of a decedent which are not properly includible in income of the taxable year in which the decedent died or of a prior year shall be included in the gross income of the estate for the taxable year in which the estate received it, if the right to such income is acquired by the estate from the decedent. Thus the amount includible in income by the estate is treated for tax purposes the same as it would have been treated had the decedent lived and received the money himself. *O'Daniel's Estate* v. *Commissioner*, 173 F. 2d 966 (C.A. 2d); *United States* v. *Ellis*, 264 F. 2d 325 (C.A. 2d).

Both courts below properly applied the applicable law to determine that the dividend income first became taxable to the estate of William Cooper in 1949. Perpetual's by-laws prohibited the cash payment of dividends to an installment account until the account matured or was surrendered to Perpetual in its entirety. (R. 209-211.) Not until 1949 did the executrix surrender the entire share account and Perpetual repurchase the shares in full from her for $117,445.65, of which $115,172.39 represented dividend credits. Before these events took place neither William nor the estate had any unqualified right to the cash represented by the dividends. Hence, there was no constructive receipt of the dividend income by William during the years 1945 through 1948. See Treasury Regulations 111, Section 29.42-3, promulgated under the Internal Revenue Code of 1939.

There is no merit to the Estate's contention that both courts below erred in failing to hold that William accrued income in the years 1945 through 1948 when the dividends were credited by Perpetual to his installment account. True, dividends may become taxable to a shareholder in the year of credit under certain circumstances. But here there was no showing by the Estate that the dividend credits were unqualifiedly subject to the demand of William or of his estate prior to 1949.[2]

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[2] *Ross* v. *Commissioner*, 169 F. 2d 483 (C.A. 1st), relied upon by the Estate (Pet. 7), is not in conflict with the decisions below. In *Ross* there was a finding that the salaries credited to an officer on the books of a corporation were unqualifiedly subject to his demand in the year in which the credits were made.

2. Section 275(a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 15) limits the assessment and collection of taxes within three years after the return is filed. However, Section 276(a) (Appendix, *infra*, p. 15) permits an assessment to be made at any time where no return is filed. Perpetual does not question the findings below that it did not file any corporate income or excess profits tax returns for the years 1945 through 1951.[3] Nor do information returns filed under Section 54(f) of the 1939 Code (Appendix, *infra*, p. 13) qualify as tax returns for Section 275(a) purposes. *Automobile Club* v. *Commissioner*, 353 U.S. 180, 188, rehearing denied, 353 U.S. 989; *Francis Edward McGillick Foundation* v. *Commissioner*, 278 F. 2d 643, 648-649 (C.A. 3d).

Furthermore, Perpetual is not entitled to any relief under Section 302(b) of the Revenue Act of 1950 (Appendix, *infra*, p. 16), which permits the filing of an information return, in certain limited circumstances, to be regarded as equivalent to the filing of a tax return for the purpose of the statute of limitations. Section 302(b) is inapplicable here since it applies only to organizations referred to in Section 302(a)—certain charitable and similar organizations exempt under paragraphs (1), (6) or (7) of Section 101—and then only if the exemption was denied on

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[3] Perpetual is not contesting the holding below (R. 175-184, Pet. 17-18), that it was not entitled to an exemption from tax under Section 101(1) of the 1939 Code (Appendix, *infra*, p. 11), and that the Commissioner may retroactively revoke an exemption previously granted.

the ground that such an organization was carrying on an unrelated business activity for profit. See S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 26-39, 117-119 (1950-2 Cum. Bull. 483, 502-512, 567-568); H. Conference Rep. No. 3124, 81st Cong., 2d Sess., p. 35 (1950-2 Cum. Bull. 580, 590). Here, Perpetual had not been granted an exemption under paragraphs (1), (6) or (7) of Section 101, and its right to an exemption had not been revoked because it had earned unrelated business income. Instead, the Commissioner's revocation was predicated upon the fact that Perpetual had not been operated in accordance with the standards set forth in Section 101(4) (Appendix, *infra*, p. 14), *i.e.*, that it had not been operated as a true building and loan association and that substantially all its business had not been confined to making loans to members.[4]

3. Section 23(b) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 13) permits a deduction for interest paid or accrued within a taxable year.

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[4] The Tax Court correctly noted (R. 186-187) that Section 6501(g) of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sec. 6501(g))—providing that, if a taxpayer determines in good faith that it is an exempt organization and files an information return, that return will be considered equivalent to the tax return of the organization for the purposes of the running of the period of limitations—is inapplicable here. This provision has no counterpart in prior law and does not apply retroactively.

Cooper Agency, insisting that it was obligated to pay Perpetual interest on $600,000, contends that the courts below erred in disallowing part of the interest deductions claimed by it in its 1950 and 1951 returns. But both courts below concluded, on the basis of adequately supported findings (R. 192-195, 198-203; Pet. 17-18), that the asserted $600,000 loan—more than actually required by Cooper Agency to finance its construction and more than actually advanced by Perpetual to Cooper Agency—was in effect nothing more than a device to permit the Cooper brothers to take a larger deduction for their taxable corporation, Cooper Agency, in the guise of interest paid, and to allocate more of the income from the sale of the 198 houses to their exempt corporation in the guise of interest. This Court will not review concurrent findings of fact in the absence of exceptional error. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214; *Corn Products Co.* v. *Commissioner*, 350 U. S. 46, 51. While Perpetual set up a so-called loan account on its books, the facts are that amounts totaling less than $600,000 were doled out to Cooper Agency as construction advanced, that Cooper Agency periodically repaid the advances as it sold houses, that Cooper Agency never owed Perpetual more than $165,000 at any one time, and that for most of the time the net outstanding balance was much smaller. Nor was there any evidence that Perpetual agreed to set aside $600,000 for the use of Cooper Agency, or that such an amount was unqualifiedly subject to the demands of Cooper Agency. (R. 64-66, 116-118, 135-136, 138, 148-150.) In the circumstances, the

disallowance of the asserted interest deduction was justified. See *Knetsch* v. *United States*, 364 U.S. 361; *1432 Broadway Corp.* v. *Commissioner*, 160 F. 2d 885 (C.A. 2d), affirming *per curiam* 4 T.C. 1158, 1164-1165; *Weller* v. *Commissioner*, 270 F. 2d 294 (C.A. 3d); see also *Gregory* v. *Helvering*, 293 U.S. 465, 469-470; *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334.[5]

CONCLUSION

The decisions below are correct; there is no conflict; the issues are primarily factual and limited to the facts of these cases and are not of general importance. Accordingly, the petition for certiorari should be denied.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.

LOUIS F. OBERDORFER,
Assistant Attorney General.

MEYER ROTHWACKS,
KARL SCHMEIDLER,
Attorneys.

NOVEMBER, 1961.

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[5] There is no conflict between the decision below and the cases, relied upon by the taxpayers (Pet. 10), in which the courts found that the respective indebtedness there involved reflected bona fide transactions in the amounts claimed.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

* * * *

SEC. 54. RECORDS AND SPECIAL RETURNS.

* * * *

(f) [As added by Sec. 117(a), Revenue Act of 1943, c. 63, 58 Stat. 21] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the

approval of the Secretary, may from time to time prescribe. * * *

* * * *

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS [53 Stat. 33].

The following organizations shall be exempt from taxation under this chapter—

* * * *

(4) Domestic building and loan associations substantially all the business of which is confined to making loans to members; and cooperative banks without capital stock organized and operated for mutual purposes and without profit;

* * * *

SEC. 126 [As added by Sec. 134(e), Revenue Act of 1942, c. 619, 56 Stat. 798]. INCOME IN RESPECT OF DECEDENTS.

(a) *Inclusion in Gross Income.*—

(1) *General rule.*—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right

to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

* * * *

SEC. 161. IMPOSITION OF TAX [53 Stat. 66].

(a) *Application of Tax.*—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property held in trust, including—

* * * *

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * *

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * *

Revenue Act of 1950, c. 994, 64 Stat. 906:

SEC. 302. EXEMPTION OF CERTAIN ORGANIZATIONS FOR PAST YEARS.

* * * *

(b) *Period of Limitations.*—In the case of an organization which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit, the filing of the information return required by section 54(f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). In the case of such an organization which was, by the provisions of section 54(f) of the Internal Revenue Code, specifically not required to file such information return, for the purposes of the preceding sentence a return shall be deemed to have been filed at the time when such return should have been filed had it been so required. The provisions of this subsection shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950, (1) any amount of tax was assessed or paid, or (2) a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer.

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